Exhibit 2

Managing Universal Service in the Public Interest

A Competitively Neutral and Legally Coherent Approach Toward Managing Fund Growth

Jim Chen

TABLE OF CONTENTS

MANAGING UNIVERSAL SERVICE IN THE PUBLIC INTEREST

A COMPETITIVELY NEUTRAL AND LEGALLY COHERENT APPROACH TOWARD MANAGING FUND GROWTH

Jim Chen*

INTRODUCTION

These comments respond to the Federal-State Joint Board's call for comments concerning certain rules issued by the Federal Communications Commission relating to support mechanisms for extending universal service in high-cost areas.[1] I write on behalf of Rural Cellular Association and the Alliance of Rural CMRS Carriers (RCA-ARC). The wireless carriers who constitute the members of RCA-ARC wish to ensure that the Commission's rules regarding the designation of eligible telecommunications carriers (ETCs) and the calculation of high-cost support will continue to advance the public interest in universal service. In particular, RCA-ARC wishes to ensure neutrality as between competitive and incumbent carriers and as between wireless and wireline technological platforms. As rural carriers, the members of RCA-ARC are also keenly interested in ensuring that "[c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services . . . that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas."[2]

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[1]*See* Comment on Certain of the Comm'n's Rules Relating to High-Cost Universal Serv. Support & the ETC Designation Process, FCC 03J-1, CC Docket No. 96-45 (released Feb. 7, 2003), 68 Fed. Reg. 10,429 (March 5, 2003) [hereinafter *Joint Board Public Notice*]; *In re* Federal-State Joint Bd. on Universal Serv., 17 F.C.C.R. 22,642 (2002) [hereinafter *November 2002 Order*].

[2]47 U.S.C. § 254(b)(3).

In adopting policies designed to ensure that all forms of universal service under the Telecommunications Act of 1996[3] are "explicit and sufficient to achieve the purposes" identified by Congress,[4] the Commission must remain faithful to the purposes that animate the universal service program and the 1996 Act as a whole. Although "overly expansive universal service mechanisms potentially could harm all consumers by increasing the cost of telecommunications services for all,"[5] and although "excess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise,"[6] any response to concerns over allegedly excessive growth in the Universal Service Fund (USF) must craft regulatory policy in accordance with the law. Under current legal, economic, and technological conditions, not all ETCs stand on equal footing. The earliest wave of ETC designations in virtually all rural markets involved incumbent carriers relying on wireline technology. Competitive carriers providing telecommunications service in these markets often deploy wireless technology. Any method of preserving and advancing universal service in these markets must uphold all components of the public interest, including neutrality as between incumbent and competitive carriers, technological neutrality, portability of support, and rural-urban parity. Any approach that effectively equates the "public interest" with incumbent protection or with the perpetuation of wireline carriage therefore constitutes an unreasonable interpretation of the 1996 Act. The Commission should endeavor to administer the universal service system and to manage the Universal Service Fund so that neither it nor its counterparts among the states will impair, much less preclude, competitive entry by wireless carriers into rural markets.

Parts I and II of these comments respond to the Joint Board's call for comments concerning the process for designating ETCs.[7] Part I provides a brief legislative background of the federal universal service program and outlines the basic legal standards that govern the ETC designation process. Part II focuses on the most important and controversial of these legal standards: the public interest inquiry that serves as a prerequisite to the designation of a second or subsequent ETC for an area served by a rural telephone company. The "public interest" as a statutory term of art must draw its meaning from the 1996 Act and other portions of Communications Act of 1934.[8] Accordingly, the public interest inquiry required by 47 U.S.C. § 214(e)(2) and 47 U.S.C. § 214(e)(6) demands adherence to such universal service principles as are outlined in 47 U.S.C. § 254(b)(1)-(6) or as have been adopted by the Joint Board and the Commission pursuant to their authority to recognize additional universal service principles. Within the ETC designation process, three elements of the public interest are paramount: neutrality as between incumbent and competitive carriers, technological neutrality, and rural-urban parity.

Part III of my comments responds to the Joint Board's call for comments concerning the methodology for calculating support in competitive study areas.[9] It examines the controversy at the heart of this proceeding: the financial pressure that the designation of multiple ETCs in rural high-cost areas is allegedly exerting on the USF. Careful scrutiny reveals that the designation of competitive eligible telecommunications carriers (CETCs) lags far behind other drivers of growth in the USF. Moreover, relative to incumbent eligible telecommunications carriers (IETCs), CETCs

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[3]Pub. L. No. 104-104, 110 Stat. 56.

[4]47 U.S.C. § 254(e); *cf. id.* § 254(b)(5) ("There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.").

[5]*In re* Federal-State Joint Bd. on Universal Serv., 12 F.C.C.R. 8776, 8829 (1997) [*hereinafter* "*First Report & Order*"], *aff'd in part, rev'd in part sub nom.* Texas Office of Public Util. Counsel v. FCC, 183 F.3d 393 (5th Cir. 1999), *cert. denied*, 530 U.S. 1210, 1223 (2000) *and cert. dismissed*, 531 U.S. 975 (2000).

[6]Alenco Communications, Inc. v. FCC, 201 F.3d 608, 620 (5th Cir. 2000).

[7]*See Joint Board Public Notice*, at ¶¶ 33-35.

[8]Act of June 19, 1934, ch. 652, 48 Stat. 1064.

[9]*See Joint Board Public Notice*, at ¶¶ 15-25.

as a class receive a trivial share of federal support for telecommunications service in high-cost areas. The Commission's current policy excludes presumed financial pressure on the USF from the consideration of ETC designation petitions. The Commission should continue to exclude this factor from the ETC designation process, because its inclusion would fatally undermine the public interest in competitive neutrality and rural-urban parity.

The primary driver of allegedly excessive growth in the high-cost component of the USF is the ongoing policy of basing high-cost support to all ETCs in rural areas on the IETC's embedded costs. As long as the Commission adheres to its embedded-cost methodology for computing high-cost support to rural IETCs, interpreting the term "public interest" logically forecloses further ETC designations whenever a competitive carrier would capture at least some lines previously served by the incumbent. The inevitability of this market-driven outcome renders absurd any reading of section 214(e)(2) and (6) in which the presumed financial impact of additional ETC designations is deemed to be detrimental to the public interest. An interpretation of the term "public interest" that permits categorically no ETC designations beyond those confirming the status of the incumbent carrier as a rural community's first and only eligible telecommunications carrier simply cannot be correct.

Part IV will outline my proposed solutions. Ideally, the Commission should retain its current approach of excluding concerns over fund growth from proceedings designed to designate a single eligible telecommunications carrier for a specific market. If the Commission must take some tangible steps toward curbing growth in the high-cost component of the USF, it must remain faithful to countervailing universal service principles such as competitive neutrality, rural-urban parity, and portability of support. Even if high-cost support is in fact exerting unsustainable pressure on the USF, and even if a desire to limit such growth may lawfully be considered a component of the public interest, the Commission should not cap high-cost funding or adopt other policies that may retard competitive entry into rural markets. Rather, because the Commission's continued adherence to an embedded-cost mechanism is the principal driver of growth in the USF's high-cost support obligations, the Commission should adopt a forward-looking methodology for computing universal service support in high-cost areas, wholly decoupled from incumbent carriers' costs. Such a methodology has been contemplated, but never implemented, since the inception of the 1996 Act's universal service program. The Commission should amend its rules to apply the same forward-looking methodology for computing high-cost support to IETCs in rural and non-rural service areas alike.

Moreover, the Joint Board should prescribe several rules addressing the uniquely anticompetitive potential of ETC designation proceedings conducted by state commissions. Specifically, the Joint Board should recommend that the Commission amend its rules to clarify the scope of the "public interest" inquiry required by Sections 214(e)(2) and (6). Under no circumstances should a state commission, in performing its tasks under section 214(e)(2), consider the financial impact that the designation of an additional ETC in a rural market may have on the solvency or stability of the USF. Because this issue will ultimately be addressed through a rulemaking process that has begun with the Joint Board's Public Notice, the Commission should maintain its existing practice of refraining from any consideration of the potential financial impact of a CETC designation on the USF.

The prospective imposition of state-law conditions concerning mandatory carriage or quality of service raises special legal considerations unique to state ETC designation proceedings. In response, the Commission should promulgate rules outlining the restraints that Sections 253, 214, and 332 place upon the discretion of state commissions to impose conditions on ETC petitions (particularly those filed by competitive wireless carriers).

Finally, the Commission should not amend its rules to vary support according to an ETC's technological platform or to cap the amount of high-cost support available to CETCs. To the extent that the Joint Board may wish to recommend changes in the Commission's current rules, it should consider instead the possibility of basing high-cost support, on a competitively neutral basis, upon the costs of a lowest-cost provider of supported telecommunications services to a rural market.

I. PROCESS FOR DESIGNATING ELIGIBLE TELECOMMUNICATIONS CARRIERS

I shall begin by addressing paragraphs 33 through 34 of the Joint Board's Public Notice because of the specific controversy that has inspired this proceeding - the alleged fiscal pressure exerted on the USF by CETC designations - can be understood only in the larger context of the process for designating ETCs. As I shall describe in greater detail, the 1996 Act distinguishes between ETC designations in "area[s] served by a rural telephone company" and ETC designations in "all other areas."[10] Whether implemented by the Federal Communications Commission or by a state commission, the designation of more than one ETC in a rural area requires an explicit "find[ing] that the designation is in the public interest."[11] The mere existence of regulatory discretion over the designation of second and subsequent ETCs in rural areas has given IETCs the opportunity to oppose their competitors' ETC designation petitions. The Commission has long recognized the potential of the ETC designation process to "discriminat[e] unfairly against" wireless carriers.[12] As competitive wireless carriers enlarge their share of the market for telecommunications service, incumbent wireline carriers have ever greater incentive to retaliate through the legal system.

The ability of incumbents to transform the ETC designation process into a weapon against competition demands that the Joint Board and the Commission, in contemplating regulatory measures designed to curb excessive growth in federal universal service obligations, take extra care to uphold the procompetitive, deregulatory, and innovation-inducing purposes of the 1996 Act. Because misinterpretation of the law can facilitate rampant discrimination against competitive wireless carriers, it is essential that the Commission adopt a legally valid interpretation of the public interest and other pivotal statutory terms.

A. Legislative Background

Comprehensive reform of universal service fulfills the 1996 Act's overarching promise to "promote competition and reduce regulation," "secure lower prices and higher quality services . . . and encourage the rapid deployment of new telecommunications technologies."[13] Universal service works in conjunction with the Commission's rules on interconnection and unbundled access[14] and on access charge reform[15] "to promote . . . policies and purposes . . . favoring diversity of media voices, vigorous economic competition, technological advancement, and promotion of the public interest, convenience, and necessity."[16] The Commission's initial Report and Order on universal

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[10]47 U.S.C. § 214(e)(2), (6).

[11]*Id.*

[12]*See In re* Implementation of § 6002(B) of the Omnibus Budget Reconciliation Act of 1993, 14 F.C.C.R. 10,145, 10,270 (1999).

[13]Pub. L. No. 104-104, 110 Stat. 56, 56 (preamble).

[14]*See, e.g., In re* Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 F.C.C.R. 15,499 (1996), *aff'd in part, rev'd in part sub nom.* AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366 (1999).

[15]*See In re* Access Charge Reform, 7 Communications Reg. (P&F) 1209 (Fed. Communications Comm'n 1997), *aff'd sub nom.* Southwestern Bell Tel. Co. v. FCC, 153 F.3d 523 (8th Cir. 1998); *In re* Access Charge Reform Price Cap Performance Review for Local Exch. Carriers, 11 F.C.C.R. 21,354 (1996).

[16]47 U.S.C. § 257(b).

service[17] belongs securely in the "competition trilogy" of rules that Chairman Reed Hundt hailed as "the most pro-competitive action of government since the break-up of the Standard Oil Trust."[18] Congress plainly intended "to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly the private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition."[19]

Preserving and extending universal service within an agenda for reform requires great legislative and regulatory finesse. The 1996 Act sought "to limit . . . rate and entry but not universal service regulation."[20] Congress understood that traditional mechanisms "for universal service are uniquely suited for a regulated market where limits on competition guarantee economic returns that are sufficient . . . to allow firms to subsidize their own high-cost consumers."[21] The traditional system of implicit subsidies could not coexist with Congress's commitment to comprehensive regulatory reform and the opening of local markets.[22] Deregulation's erosion of "near-guaranteed returns" heightened the need to coordinate universal service with "an orderly transition from a regulated market to a competitive and deregulated market."[23] The 1996 Act elected to bridge the gap by demanding that all universal service support "be explicit."[24] All implicit subsidies are now illegal.[25] Adopting the principle "that any support mechanisms continued or created under" the new statute "should be explicit, rather than implicit as many support mechanisms" had been,[26] represented "a great improvement because it move[d] the scheme for universal service out from between the lines of the incumbents' rate structures and place[d] it in the light of day."[27]

B. Legal Standards

Full understanding of the ETC designation process and its contribution to the preservation and advancement of universal service demands mastery of no fewer than six distinct sources of binding legal standards.

First, 47 U.S.C. § 214(e) establishes basic eligibility criteria for all carriers seeking federal universal service support. Section 214(e) prescribes the same substantive criteria for all ETC

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[17]*See* 12 F.C.C.R. 8776.

[18]*In re* Implementation of the Local Competition Provisions, *In re* Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 F.C.C.R. 15,499, 16,239 (1996) (separate statement of Chairman Hundt), *aff'd in part, rev'd in part sub nom.* AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366 (1999).

[19]H.R. CONF. REP. NO. 488, 104th Cong., 2d Sess. 113 (1996).

[20]Cellular Telecommunications Indus. Ass'n v. FCC, 168 F.3d 1332, 1337 (D.C. Cir. 1999).

[21]H.R. REP. NO. 204, 104th Cong., 1st Sess. 68 (1995), *reprinted in* 1996 U.S.C.C.A.N. 10, 33.

[22]*See* Texas Office of Public Util. Counsel v. FCC, 183 F.3d 393, 406 (5th Cir. 1999) [hereinafter *TOPUC*], *cert. denied*, 530 U.S. 1210, 1223 (2000) *and cert. dismissed*, 531 U.S. 975 (2000).

[23]*Id.*; *see also* S. REP. NO. 23, 104th Cong. 1st Sess. 5 (1995) [hereinafter S. REP. NO. 104-23] (linking universal service with Congress's desire to promote "competition for local telephone service by cable, wireless, long distance, and satellite companies, and electric utilities, as well as other entities").

[24]47 U.S.C. § 254(e).

[25]*See* Comsat Corp. v. FCC, 250 F.3d 931, 938 (5th Cir. 2001); *Alenco*, 201 F.3d at 623; *TOPUC*, 183 F.3d at 425; Southwestern Bell Tel. Co. v. FCC, 153 F.3d 523, 537-38 (8th Cir. 1998).

[26]H.R. CONF. REP. NO. 458, 104th Cong., 2d Sess. 131 (1996), *reprinted in* 1996 U.S.C.C.A.N. 124, 142.

[27]John W. Berresford, *The Future of the FCC: Promote Competition, Then Relax*, 50 ADMIN. L. REV. 731, 761 (1998); *cf.* Qwest Corp. v. FCC, 258 F.3d 1191, 1196 (10th Cir. 2001) (acknowledging how universal service before 1996 was accomplished through "a combination of explicit monetary payments to local phone companies and implicit subsidies through rate designs," especially the imposition of "uniform rates throughout a company's service area, which enabled the company to charge above-cost rates in urban areas to support below-cost rates in rural areas").

petitions regardless of whether they are approved by the Federal Communications Commission or by state commissions.

Statutory origins are especially critical in the application of the second and perhaps this setting's most important legal standard: the "public interest" in designating more than one ETC in a rural market. Far from being an open-ended mandate for unbounded administrative decisionmaking, the public interest standard draws its meaning from the statutory provisions that govern the federal universal service program.

Third, the Commission's interpretations of the 1996 Act and other statutory provisions governing the universal service program constitute a source of binding legal standards in their own right. In particular, the Commission's reasonable interpretations of the term "public interest" (which, it bears repeating, is statutory in origin) merit judicial deference.[28]

Three additional sources of law apply with special force to ETC designations by state commissions. In reviewing the Commission's *First Report and Order* on universal service, the United States Court of Appeals for the Fifth Circuit held that the Commission could not categorically "prohibit the states from imposing additional eligibility requirements on carriers otherwise eligible to receive federal universal service support."[29] The Fifth Circuit nevertheless recognized at least one limitation on the regulatory discretion of state commissions. "[E]ligibility requirements" that are so "onerous . . . that no otherwise eligible carrier could receive designation . . . would probably run afoul of § 214(e)(2)'s mandate to 'designate'" carriers eligible for federal universal service support.[30] Insofar as section 214(e)(6) imposes an identical "mandate to 'designate' carriers" in proceedings falling within exclusive federal jurisdiction, the same limitation constrains the discretion of the Federal Communications Commission.

Preemption under the 1996 Act supplies two final sources of law. Section 253(a) of the Act preempts state-law provisions that "prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service."[31] Finally, the preemptive power of 47 U.S.C. § 332 deprives the states and their local subdivisions of "authority to regulate the entry of or the rates charged by any commercial mobile service."[32] Section 332 thus preempts state-law requirements that might otherwise burden prospective ETCs that would deliver federally supported services over commercial mobile radio service (CMRS) facilities.

After describing the basic statutory criteria that govern ETC designation proceedings, whether they are conducted by the Commission or by its counterparts among the states, I shall dedicate Part II of these comments to a detailed examination of the public interest standard. References to all sources of law affecting the universal service program, including the basic ETC designation criteria and the public interest standard, will appear throughout the balance of these comments.

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[28]*See* Chevron U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837, 842-43 (1984); RT Communications, Inc. v. FCC, 201 F.3d 1264, 1267 (10th Cir. 2000).

[29]*TOPUC*, 183 F.3d at 418.

[30]*Id.* at 418 n.31.

[31]47 U.S.C. § 253(a).

[32]*Id.* § 332(c)(3)(A).

C. Designation Criteria for Eligible Telecommunications Carriers

In order to receive federal universal service support, a carrier must be designated an eligible telecommunications carrier.[33] To secure designation, an ETC must "offer the services that are supported by Federal universal support mechanisms."[34] It must do so "using its own facilities or a combination of its own facilities and resale of another carrier's services."[35] Moreover, the would-be ETC must "advertise the availability of such services and the charges therefor using media of general distribution."[36]

The designation of ETCs in rural markets requires an additional step. In markets subject to the jurisdiction of a state regulatory commission, the relevant "State commission *may*, in the case of an area served by a rural telephone company, and *shall*, in the case of all other areas, designate more than one common carrier as an eligible telecommunications carrier, so long as each additional requesting carrier meets the requirements" set out in section 214(e)(1).[37] "Before designating an additional eligible telecommunications carrier for an area served by a rural telephone company, the State commission shall find that the designation is in the public interest."[38] "In the case of a common carrier . . . not subject to the jurisdiction of a State commission," the Federal Communications Commission performs an identical public interest inquiry in lieu of its state-law counterpart.[39]

To repeat and summarize: paragraphs (1), (2), and (6) of 47 U.S.C. § 214(e) set forth four distinct requirements for a carrier seeking ETC designation:

1. The carrier must "offer the services that are supported by Federal universal support mechanisms."
2. The carrier must use either "its own facilities or a combination of its own facilities and resale of another carrier's services."
3. The carrier must "advertise the availability of such services and the charges therefor using media of general distribution."
4. Designation of the carrier as an ETC must be "consistent with the public interest, convenience, and necessity." Where the service area at issue belongs to "a rural telephone company," either the Commission or its counterpart in the relevant state must explicitly "find that the designation is in the public interest."

The "public interest" is the most contentious of these requirements. The Public Notice announcing this proceeding has accordingly invited comments regarding the factors that "the Commission [should] consider in determining whether designation of more than one ETC is consistent with the public interest, convenience, and necessity."[40] Part II of these comments examines this statutory requirement in greater detail.

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[33] *See id.* §§ 214(e)(1), 254(e).

[34] *Id.* § 214(e)(1).

[35] *Id.*

[36] *Id.*

[37] *Id.* § 214(e)(2) (emphases added).

[38] *Id.*

[39] *Id.* § 214(e)(6); *see also* Procedure for Designation of Eligible Telecommunications Carriers Pursuant to Section 214(e)(6) of the Communications Act, 63 Fed. Reg. 162 (Jan. 5, 1998).

[40] *Joint Board Public Notice*, at ¶ 33.

II. DETERMINING THE PUBLIC INTEREST

A. The Appropriate Public Interest Analysis

Both the Commission and its state-law counterparts must conduct the public interest analysis required by section 214(e) according to statutory baselines established by the 1996 Act and by other provisions of the Communications Act of 1934. The open-ended phrase "public interest" takes its "meaning from the purposes of the regulatory legislation" that defines the relevant agency's responsibilities.[41] Statutory "policy is the yardstick by which the correctness of" a regulatory agency's "actions will be measured."[42] Although the public interest standard is "a supple instrument for the exercise of discretion by [an] expert body," it is likewise a charter by "which Congress has charged" the Commission and the states "to carry out its legislative policy."[43] The public interest "criterion is not to be interpreted as setting up a standard so indefinite as to confer an unlimited power."[44] Rather than indulge the "mistaken assumption that" a statutory invocation of the public interest "is a mere general reference to public welfare without any standard to guide determinations," a regulatory commission must confine its analysis to "[t]he purpose of the [1996] Act, the requirements it imposes, and the context of the provision[s] in question."[45]

A statute-based approach to determining the public interest binds any legal entity authorized to conduct such an analysis. The Commission, other federal agencies, and the states must all heed congressional directives: "If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."[46] None of these decision makers enjoys *carte blanche* to render decisions without regard to the 1996 Act. "Congress [never] intended for state commissions" or the Federal Communications Commission "to have unlimited discretion" to determine the public interest in connection with petitions for ETC designation in rural areas.[47] The failure to adopt a "limiting standard, rationally related to the goals of the Act," in interpreting the public interest constitutes reversible error.[48]

The political economy of telecommunications law in general and universal service administration in particular places a great premium on a proper understanding of the public interest. Equating the public interest with an unlawful call for incumbent protection is one of the most common errors in the law of economic regulation. This misapplication of the public interest standard is especially likely when opponents of new service characterize existing networks as "adequate," describe new infrastructure as "redundant" or "duplicative," or undervalue the advantages offered by technologically diverse platforms. The law's proper focus on consumer welfare precludes assessments of the public interest that rest "on the bare conclusion that existing . . . service" is "adequate."[49] A survey of the relevant market's need for service must consider "the

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[41]NAACP v. FPC, 425 U.S. 662, 669 (1976); *accord*, *e.g.*, Office of Communication of the United Church of Christ v. FCC, 707 F.2d 1413, 1427 (D.C. Cir. 1983); Bilingual Bicultural Coalition on Mass Media, Inc. v. FCC, 595 F.2d 621, 628 & n.22 (D.C. Cir. 1978).

[42]Schaffer Transp. Co. v. United States, 355 U.S. 83, 88 (1957).

[43]FCC v. Pottsville Broadcasting Co., 309 U.S. 134, 138 (1940); *accord* FCC v. WNCN Listeners Guild, 450 U.S. 582, 593 (1981).

[44]Federal Radio Comm'n v. Nelson Bros. Bond & Mortgage Co., 289 U.S. 266, 285 (1933).

[45]New York Cent. Secs. Corp. v. United States, 287 U.S. 12, 24 (1932).

[46]*Chevron*, 467 U.S. at 842-43.

[47]Western Wireless Corp. Petition for Preemption of an Order of the South Dakota Pub. Utils. Comm'n, 15 F.C.C.R. 15,168, 15,180 (2000) [hereinafter *South Dakota Preemption Order*].

[48]AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366, 388 (1999); *accord Qwest*, 258 F.3d at 1202.

[49]*Schaffer*, 355 U.S. at 90.

inherent advantages of the proposed service," lest regulators give incumbent service providers "unwarranted protection from competition from others."[50] Lower prices also matter. "The ability of one mode of [communication] to operate with a rate lower than competing types of [communication] is precisely the sort of 'inherent advantage' that . . . congressional policy" seeks to foster.[51] The law of regulated industries recognizes a strong public interest in the "lower cost of equipment, operation, and therefore service" as one of the "inherent advantages" of any mode of communication.[52] In sum, "no carrier is entitled to protection from competition in the continuance of a service that fails to meet a public need, nor, by the same token, should the public be deprived of a new and improved service because it may divert some traffic from other carriers."[53]

The baneful tendency to equate the public interest with incumbent protection arises from a fundamental misunderstanding of the nature of competition among publicly subsidized firms. Incumbent carriers routinely decry the introduction of competition in rural markets, especially through the extension of universal service support to competitive carriers, as a form of subsidized, "artificial competition."[54] The trouble with condemning universal service support for competitive carriers as "artificial," however, is that incumbent rural telephone companies are themselves the products of public policies consciously adopted and deliberately intended to subsidize telecommunications service in remote areas where the cost of delivering service is extremely high. Incumbent carriers cannot simultaneously condemn policies extending subsidies to their competitors and demand the continued flow of support to their own coffers. When an incumbent carrier depends so heavily upon public largesse, a public decision to subsidize a competitor is no more "artificial" than the incumbent's dominance of that market is "natural."

This problem has a legal dimension as well as an economic one. Incumbent carriers evidently fail to understand what Congress hoped to achieve by "establishing a public interest requirement for those areas served by rural telephone companies."[55] IETCs often argue that the difference in statutory standards governing the designation of ETCs in rural and nonrural markets can (and should) be honored through the denial of competitive carriers' ETC designation petitions. Congress, however, intended not so much to facilitate the denial of competitive ETC designation petitions as to ensure "that consumers in rural areas continue to be adequately served should the incumbent carrier exercise its option to relinquish its ETC designation" under 47 U.S.C. § 214(e)(4).[56] As long as a petitioning carrier can "demonstrate[] both the commitment and ability to provide service to any requesting customer within the designated service area using its own

[50] *Id.* at 91.

[51] *Id.*

[52] ICC v. Mechling, 330 U.S. 567, 575 (1947); *accord* Dixie Carriers, Inc. v. United States, 351 U.S. 56, 59 (1956).

[53] *Schaffer*, 355 U.S. at 91 (internal quotation marks omitted).

[54] *See, e.g.*, National Telecommunications Coop. Ass'n, Press Release, *Telecom Industry Group Addresses Universal Service at Senate Hearing* (April 3, 2003) <http://www.ntca.org/press/releases/pr_040203.html> (arguing that Congress should "[e]nsur[e] that current law be adhered to which mandates that universal service support be provided for actual cost recovery and not be used as a tool to incite artificial competition"); Hutchinson Tel. Co. & Telecommunications, Inc., Press Release, <http://www.hutchtel.net/html/s_press_C.html> (n.d.) (denouncing a Minnesota bill that allegedly "would impose artificial competition in areas where an efficient market can only support one provider"); Reply Comments of GTE Alaska Inc., In re Consideration of Market Structure Rules Governing Local Exch. Competition in Alaska, No. R-97-12, at 3 (opposing the revocation of all rural exemptions for telecommunications carriers in Alaska by arguing that "Alaskans will benefit most by fair policies that allow competitive markets to develop naturally rather than by artificial competition that is hurriedly manufactured by government edict") (available at <http://www.state.ak.us/rca/r97012/GTE9712R.PDF>).

[55] Western Wireless Corp., 16 F.C.C.R. 18,133, 18,139 (2001).

[56] *Id.*; *accord, e.g.*, Cellular South License, Inc., 17 F.C.C.R. 24,393, 24,402-03 (2002); RCC Holdings, Inc., 17 F.C.C.R. 23,532, 23,541 (2002).

facilities" and thereby ensure "that consumers in the affected rural areas will . . . continue to be adequately served should the incumbent carrier seek to relinquish its ETC designation," the public interest favors approval of the competitive ETC petition.[57]

A complete cure for the tendency to equate the public interest with incumbent protection, however, demands a more systematic approach toward understanding the significance of "public interest" as a statutory term. The "limiting standard[s]"[58] that define the appropriate scope of the public interest standard must therefore be based upon sections 214 and 254 of the Communications Act and upon the Commission's rules and orders interpreting those provisions.

In 47 U.S.C. § 254(b), Congress has prescribed six universal service principles and set forth a framework for adopting "other principles":

> 1. The availability of "[q]uality services . . . at just, reasonable, and affordable rates."
>
> 2. "Access to advanced telecommunications and information services . . . in all regions of the Nation."
>
> 3. The goal of ensuring parity among "[c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas," so that these consumers may "have access to telecommunications and information services, including interexchange services and advanced telecommunications services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas."
>
> 4. The principle that "[a]ll providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service."
>
> 5. The existence of "specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."
>
> 6. Access for "[e]lementary and secondary schools and classrooms, health care providers, and libraries . . . to advanced telecommunications services."
>
> 7. "Such other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity . . . ."[59]

The Joint Board and the Commission have exercised on exactly one occasion their power to adopt additional universal service principles as "are necessary and appropriate for the protection of the public interest, convenience, and necessity."[60] In its initial report and order on universal service, the Commission accepted the Joint Board's recommendation to adopt "competitive neutrality" as a seventh universal service principle in addition to the six statutory principles outlined in the 1996

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[57] *RCC*, 17 F.C.C.R. at 23,541.
[58] *Iowa Utils. Bd.*, 525 U.S. at 388.
[59] 47 U.S.C. § 254(b).
[60] *Id.* § 254(b)(7).

Act itself.[61]

Among these universal service principles, competitive neutrality and rural-urban parity figure most prominently within the process for designating ETCs in rural markets. I shall now examine those principles in greater detail.

B. Competitive Neutrality: As Between Carriers and as Between Technologies

"Competitive neutrality" plays a crucial role in the determination of the public interest. Competitive neutrality, "in the context of determining universal service support," is defined as follows:

> Universal service support mechanisms and rules should be competitively neutral. In this context, competitive neutrality means that universal service support mechanisms and rules neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another.[62]

In adopting this principle, the Commission observed that some form of competitive neutrality already pervades many other provisions of the 1996 Act. In particular, neutrality permeates the requirement that universal service support be "explicit," the requirement that state universal service contributions be "equitable and nondiscriminatory," and the availability of ETC status to any carrier that meets the criteria stipulated in the Act.[63]

The principle of competitive neutrality contains two distinct components: neutrality as between service providers, plus technological neutrality. Regulators must take care not only to treat competitive carriers on an equal basis *vis-à-vis* incumbent carriers, but also to avoid privileging any technology over another. Technological neutrality offers two distinct benefits. First, by "allow[ing] the marketplace to direct the advancement of technology," technological neutrality will enhance consumer choice.[64] Second, technological neutrality improves the public administration of universal service by helping regulators to "avoid limiting providers of universal service to modes of delivering that service that are obsolete or not cost effective."[65] The Commission expected that its "policy of technological neutrality" would "foster the development of competition" and deter the unfair exclusion of "certain providers, including wireless" carriers, "that may have been excluded in participation in universal service mechanisms if . . . universal service eligibility criteria" had been interpreted "so as to favor particular technologies."[66]

Critically, the Commission maintained its commitment to competitive neutrality in the context of CETC designations for rural areas. During public commentary on what became the *First Report and Order* on universal service, the Rural Telephone Coalition urged that the promotion of competition in rural areas be considered "secondary to the advancement of universal service."[67] The Commission rejected this suggestion as "present[ing] a false choice between competition and

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[61]*See First Report & Order*, 12 F.C.C.R. at 8879, 8801; *cf.* 47 U.S.C. § 254(b)(1)-(6).

[62]*First Report & Order*, 12 F.C.C.R. at 8801.

[63]*See* 47 U.S.C. § 254(e), (f); *id.* § 214(e). *See generally First Report & Order*, 12 F.C.C.R. at 8801.

[64]*First Report & Order*, 12 F.C.C.R. at 8802.

[65]*Id.*

[66]*Id.*

[67]*Id.* at 8802-03.

universal service."[68] Rather, the Commission predicted, "competitive neutrality will promote emerging technologies that, over time, may provide competitive alternatives in rural, insular, and high cost areas and thereby benefit rural consumers."[69] Consistent with the *First Report and Order*'s endorsement of technological neutrality as an essential component of the public interest, the Commission has expressly prohibited discrimination on the basis of a petitioning carrier's technological platform: "A state commission shall designate a common carrier that meets the requirements of this section as an eligible telecommunications carrier irrespective of the technology used by such carrier."[70]

1. Neutrality as between carriers. The requirement of neutrality as between service providers means that the designation *vel non* of an ETC should hinge solely on those factors that rational consumers weigh in choosing between an incumbent carrier and its competitor: superior price, quality, and support. The public interest depends on consumer choice, not on the competitive threat that market entry may pose to an IETC. Consumer choice, as measured by the market-driven decisions of a substantial majority of residential customers, is an essential component of the public interest. Congress has directed the Joint Board and the Commission to consider "the extent to which such telecommunications services . . . have, *through the operation of market choices by customers*, been subscribed to by a substantial majority of residential customers."[71] Technological innovations by service providers are also relevant, for the Joint Board and the Commission must also consider "the extent to which . . . telecommunications services . . . are being deployed in public telecommunications networks by telecommunications carriers."[72] The primacy of consumer choice in public interest analysis precludes the assumption that the terms and conditions of local service provided by a competitive carrier should match the terms and conditions of service offered by an IETC. Diversity among options for "local usage" - including but not limited to variations in price, the number of minutes available without additional charge, the geographic boundary between local and long distance service, and the ability to make and receive calls while away from home - should be considered as having a positive rather than negative impact on the public interest.

2. Technological neutrality. The Commission has unambiguously insisted that "a common carrier that meets the requirements" for ETC designation shall be so designated "irrespective of the technology used by such carrier."[73] Practically speaking, this requirement means that an ETC designation decision must not hinge upon the fulfillment of requirements that have no technological analogue in a wireless platform. Nor should the Commission define supported services and universal service mechanisms according to offerings made by wireline IETCs. The Commission has squarely "reject[ed] the contention" - advanced, unsurprisingly, by a wireline incumbent - that a wireless carrier "lacks the 'requisite quality and reliability' because it relies on a 'handheld' cellular technology."[74] The Commission found "[n]o credible evidence" supporting the exclusion of wireless providers from eligibility for USF support "due to [the] alleged technological limitations of mobile service."[75] Ultimately, the Commission rejected an even more aggressive proposal to "impose a 'landline substitutability' requirement" that would have erected a massive barrier to CETC designation.[76]

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[68] *Id.* at 8803.

[69] *Id.*

[70] 47 C.F.R. § 54.201(h).

[71] 47 U.S.C. § 254(c)(1)(B) (emphasis added).

[72] 47 U.S.C. § 254(c)(1)(D).

[73] 47 C.F.R. § 54.201(h).

[74] Cellco Partnership d/b/a Bell Atl. Mobile, 16 F.C.C.R. 39, 43 (2000).

[75] *Id.*

[76] *Id.* at 44.

A statute dedicated to reforming markets "affected with a public interest" should be interpreted so as to favor technological innovation over incumbent protection.[77] The public interest depends on the development, deployment, and "provision of new technologies and services to the public."[78] The public interest standard bars regulators from "penaliz[ing] innovation . . . by declaring each new and innovative service offering or operating mode a discrete submarket subject to unique regulatory . . . treatment."[79] The 1996 Act provides that "[u]niversal service is an evolving level of telecommunications services that the Commission shall establish periodically, taking into account advances in telecommunications and information technologies and services."[80] Updating the definition of universal service helps "ensure that the conduit, whether it is a twisted pair wire, coaxial cable, fiber optic cable, wireless, or satellite system, has sufficient capacity and technological capability to enable . . . interconnect[ion] to . . . the telecommunications network."[81] For instance, although "touch tone telephone service is widely . . . used [today] by a substantial majority of residential customers," touch tone service might, like conventional "rotary party line service" before it, eventually fail "to meet the minimum definition of universal service."[82] In short, no assessment of the public interest can ignore changes in technological capacity and consumer choice.

Two specific features of the universal service program reflect the federal commitment to technological improvement. First, federal law strongly favors facilities-based competition. To qualify as an ETC, a carrier must either "us[e] its own facilities" or, at a minimum, combine "its own facilities" with "resale of another carrier's services."[83] No carrier that conducts its business solely by reselling services provided by another carrier can receive federal universal service support. Second, the specifics of federal universal service administration reinforce the preference for facilities-based competition. The Commission's rules grant a CETC "the full amount of universal service support that the incumbent LEC would have received for [a new] customer," but only to the extent that the CETC "provides the supported services using neither unbundled network elements purchased" from an IETC "nor wholesale service purchased" from the IETC.[84] The same conditions govern full support for CETC provision of federally supported services previously delivered by an IETC – and the corresponding reduction of federal support to the IETC in question.[85] Neither the 1996 Act nor the Commission's rules prescribe the technological path a CETC is expected to follow. It is sufficient that a CETC build its own facilities, at least in part, so that consumers will enjoy alternative sources of telecommunications service and so that competitive and incumbent ETCs alike will have an incentive to improve the technological platforms on which their businesses rest.

Technological progress advances the public interest even when it is reflected in new services not directly supported by the federal universal service program. Although the Commission has declined to add "advanced or high-speed services" to the list of services supported by the USF,[86] the Commission has reaffirmed the principle that federal "universal service policies should not

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[77]Munn v. Illinois, 94 U.S. 113, 130 (1877).

[78]47 U.S.C. § 157(a); *see* Jerry Hausman & Howard Shelanski, *Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Universal-Service Subsidies*, 16 YALE J. ON REG. 19, 27-28 (1999).

[79]United States v. FCC, 652 F.2d 72, 99 (D.C. Cir. 1980).

[80]47 U.S.C. § 254(c)(1).

[81]S. REP. NO. 104-23, at 27.

[82]*Id.*

[83]47 U.S.C. § 214(e)(1)(A).

[84]47 C.F.R. § 54.307(a)(3).

[85]*See id.* § 54.307(a)(4).

[86]*In re* Federal-State Joint Bd. on Universal Serv., 17 F.C.C.R. 14,095, 14,102 (2002) [hereinafter *July 2002 Recommended Decision*].

inadvertently create barriers to the provision [of] or access to advanced services."[87] In other words, even if text messaging and wireless Internet access currently fall outside the list of supported services, the federal universal service program encourages "the deployment of modern plant capable of providing access to [such] services."[88]

C. Rural-Urban Parity

Congress has expressed a strong public interest in rural-urban parity. In designing the federal universal service program, Congress took pains to ensure that rural consumers would not be disadvantaged *vis-à-vis* their urban counterparts. The 1996 Act directs the Commission to "adopt rules to require that the rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each provider to its subscribers in urban areas."[89] This provision was designed "to incorporate the policies of geographic rate averaging and rate integration of interexchange services" so that subscribers in rural and high-cost areas would be "able to continue to receive both intrastate and interstate interexchange services at rates no higher than those paid by urban subscribers."[90] Designation of a CETC therefore advances the public interest to the extent the entrant can carry calls that an IETC would treat as long distance. Given the greater geographic scope of many rural dwellers' daily lives, a CETC's ability to provide a local calling area that transcends the physical footprint of a wireline-based IETC significantly advances the public interest. Statically depicting universal service as local exchange access on a wireline platform also ignores the value that accrues to rural residents when others traveling in their communities are able to use new wireless infrastructure to roam.[91]

Wireless platforms offer an economically rational and highly efficient method of intermodal competition, particularly in rural and other high-cost areas. Wireless telecommunications media perform most effectively where dispersed populations, forbidding climates, or "unaccommodating" terrain compromises the effectiveness of a wireline network and raises its operating costs.[92] At least under the existing state of communications technology, wireless platforms promise the most economically robust alternative to wireline legacy networks.[93] By extending "the full amount of universal service support that [an] incumbent LEC would . . . receive" per customer to a "competitive eligible telecommunications carrier that provides . . . supported services using neither unbundled network elements . . . nor wholesale service" purchased from an IETC, the federal universal service program strongly favors this very sort of facilities-based competition.[94]

D. Faulty Analyses of the Public Interest: False Negatives and False Positives

Faulty public interest analyses fall into two broad categories: those yielding "false negatives"

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[87]Multi-Association Group (MAG) Plan for Regulation of Interstate Servs. of Non-Price Cap Incumbent Local Exch. Carriers & Interexchange Carriers, 16 F.C.C.R. 11,244, 11,322 (2001) [hereinafter *MAG Plan*]; *accord July 2002 Recommended Decision*, 17 F.C.C.R. at 14,102.

[88]*MAG Plan*, 16 F.C.C.R. at 11,323; *accord July 2002 Recommended Decision*, 17 F.C.C.R. at 14,102.

[89]47 U.S.C. § 254(g).

[90]S. CONF. REP. NO. 230, 104th Cong., 2d Sess. 132 (1996).

[91]*See TOPUC*, 183 F.3d at 406 n.2.

[92]*See Alenco*, 201 F.3d at 617 ("Rural areas where telephone customers are dispersed and terrain is unaccommodating are ... the most expensive to serve.").

[93]*See, e.g.*, Lisa M. Warner, *Wireless Technologies Creating Competition in the Local Exchange Market: How Will Local Exchange Carriers Compete?*, 4 COMMLAW CONSPECTUS 51, 52 (1996); Eric Thoreson, Comment, *Farewell to the Bell Monopoly? The Wireless Alternative to Local Competition*, 77 OR. L. REV. 309, 336 (1998).

[94]47 C.F.R. § 54.307(a)(3), (4).

and those yielding "false positives." So far I have focused on false negatives, anticipating those circumstances in which the ETC designation process dishonors one or both dimensions of competitive neutrality, or ignores a prospective CETC's contribution toward rural-urban parity. The distinct problem of false positives arises when public interest analysis rests upon an irrelevant or improper factor. Presumed USF growth due to the designation of competitive ETCs can and should be regarded as a false positive in public interest analysis. Part III of these comments, which will address the methodology for calculating support in competitive study areas, will demonstrate why any rule incorporating the presumed fiscal impact of competitive entry on the high-cost component of the USF is unworkable and ultimately cannot be reconciled with the public interest standard.

III. THE METHODOLOGY FOR CALCULATING SUPPORT IN COMPETITIVE STUDY AREAS

A. The True Impact of CETC Designations on Growth in the Universal Service Fund

At the outset, I must stress the actual financial impact of competitive entry on the USF. Accuracy in describing this real-life phenomenon varies inversely with the intensity with which interested parties advocate measures purportedly intended to remedy the supposed crisis in fund growth. Although proposals to freeze high-cost support abound, honest statements of the fiscal impact of competitive entry on the USF are relatively rare. High-cost support trails other sources of growth in the USF by a wide margin. According to data collected by the National Exchange Carrier Association, support programs for schools and libraries, rural health care, and interstate access have more than doubled the size of the USF since 1998. By contrast, the high-cost support and lifeline programs have increased by only 30 percent.[95]

Within the portion of the USF dedicated to high-cost support, CETCs account for a trifling share. During the third quarter of 2002, competitive carriers received approximately $14 million out of $803 million in total high-cost support disbursed by the USF.[96] The resulting 1.8 percent share of total high-cost support is admittedly higher than the 0.4 percent share realized by CETCs during the first quarter of 2001 (when CETCs received approximately $2 million out of $638 million in high-cost support).[97] The numerical imbalance between competitive versus incumbent ETCs is equally striking. Among approximately 1,400 ETCs in the United States, only 45 are competitive carriers.[98] Within the subclass of CETCs, only 15 are mobile wireless providers; the remainder are competitive local exchange companies.[99] In other words, a roll call of ETCs in the United States would report a class consisting of roughly 97 percent IETCs, 2 percent CETCs using wireline or fixed wireless platforms, and 1 percent CETCs providing mobile wireless service. Although the debate over subsidized rural telephony has somehow subordinated incumbent carriers' overwhelming share of the USF to the supposed contribution of competitive ETC designations to allegedly unsustainable growth in the fund, the truth remains that IETCs continue to receive more than 98 cents on the federal high-cost support dollar. Likewise, cries of excessive growth – and the accompanying demands for regulatory retribution – issue forth from a class of carriers who outnumber their most dreaded competitors by nearly 100-to-1.

Moreover, as Mr. Don Wood demonstrates in his comments on behalf of RCA-ARC,[100] not all growth within the USF is equally worrisome from a public policy perspective. Growth

[95] *See NECA End User Study, November 2002 at iv.*

[96] *See November 2002 Order*, 17 F.C.C.R. at 22,643-44; *Joint Board Public Notice*, at ¶ 10.

[97] *See November 2002 Order*, 17 F.C.C.R. at 22,644; *Joint Board Public Notice*, at ¶ 10.

[98] *See Joint Board Public Notice*, at ¶ 10.

[99] *See id.*

[100] *See Wood Comments*, at 11.

attributable to economic development in rural areas and to increased consumer demand for telecommunications and advanced services is hardly objectionable. If anything, this sort of growth indicates that universal service is achieving one of its goals, that of extending equality of economic opportunity from America's cities into the nation's countryside. By contrast, USF growth driven by the rising average costs of delivering telecommunications service over a wireline network may reflect the needless diversion of public money to sustaining obsolete facilities. Support paid to wireless carriers tends to contribute to benign or even desirable growth in the USF. To the extent that a larger amount of universal service financing is being disbursed to cover rising average costs incurred by IETCs, such growth may give rise to legitimate policy concerns. Blame for such deleterious growth, however, cannot be fairly laid at the feet of competitive wireless entrants into high-cost markets. Again, incumbent carriers' calls to control growth in federal universal service obligations take no account of these subtleties, which upon closer examination provide no support for fearing (let alone curbing) wireless entry.

The striking disparity between allegations of out-of-control growth and the modest magnitude of actual growth suggests that the Commission has real reason to worry about the potentially anticompetitive manipulation of rules governing ETC designation and universal service financing. The unbroken string of demands to freeze high-cost support within the USF – launched during the prologue to the *First Report and Order* and never abandoned since – represents a prime instance of the process by which diehard partisans try to turn even outrageous myth into history through relentless repetition. Portraying CETC designations as a one-way ratchet forcing growth in the USF has no basis in law or in fact. A proper understanding of the underlying financial mechanism demonstrates that growth in the fund through competitive entry into rural markets is probably speculative and almost assuredly trivial. Worse, freezing the USF would contradict the principle of portability, which represents one of the most salutary, technology-forcing characteristics of the universal service program. The real driver of growth in the high-cost component of the USF is the continued use of an embedded-cost methodology for subsidizing incumbent rural carriers. As long as the Commission retains that methodology, no rule purporting to control USF growth by retarding the pace of CETC designations or curbing the total amount of high-cost support can be compatible with the public interest.

Before exploring these propositions in detail, I shall outline the Commission's current policy, which has hitherto excluded any consideration of competitive entry's presumed fiscal impact from the process for designating ETCs.

B. The Commission's Current Policy

The Commission's current rules do not treat the presumed financial impact of ETC designations on the USF as a component of the public interest. The Commission has repeatedly and consistently rebuffed calls to relieve financial pressure on the growth of the USF, whether by curbing CETC designations or by freezing high-cost support levels. In its initial review of this issue, the Commission "reject[ed] proposals to establish a principle to minimize the size and growth of the universal service fund."[101] Instead, the Commission expressed its confidence in the ability of "competitive and market-based universal service techniques" to "limit the size of the support mechanisms by providing affordable, cost-effective telecommunications services in many regions of the nation that are now dependent upon universal service support."[102] Three years after the issuance of the *First Report and Order*, the Commission found "no merit to the contention that designation of an additional ETC in areas served by rural telephone companies will necessarily create

[101] *First Report & Order*, 12 F.C.C.R. at 8805.

[102] *Id.* at 8806.

incentives to reduce investment in infrastructure, raise rates, or reduce service quality to consumers."[103] "To the contrary," the Commission reasoned, "competition may provide incentives to the incumbent to implement new operating efficiencies, lower prices, and offer better service."[104]

In 2001, the Commission's *MAG Plan Order* addressed the Rural Task Force's concern that "excessive growth in the fund" might occur "if incumbent carriers lose many lines to competitive eligible telecommunications carriers, or if competitive eligible telecommunications carriers add a significant number of lines."[105] The Commission acknowledged the Rural Task Force's description of how CETC capture of service previously delivered by an IETC might propel growth in the USF:

> [A]s an incumbent "loses" lines to a competitive eligible telecommunications carrier, the incumbent must recover its fixed costs from fewer lines, thus increasing its per-line costs. With higher per-line costs, the incumbent would receive greater per-line support, which would also be available to the competitive eligible telecommunications carrier for each of the lines that it serves.[106]

The Commission, however, rejected the Rural Task Force proposal to freeze high-cost support levels. It characterized the likelihood that a CETC would "captur[e] a substantial percentage of lines from the incumbent" as "speculative."[107] Among the plan's "significant drawbacks," the Commission reasoned that freezing high-cost support would create "disincentives to infrastructure investment by rural carriers."[108] The most compelling justification for the Commission's refusal to freeze high-cost support, however, lay in the ability of incumbent carriers to transform putative concern over the solvency of the fund into a legal bludgeon against competition. The *MAG Plan Order* recognized that a freeze in support could "hinder . . . competitive entry into rural study areas by creating an additional incentive for incumbents to oppose the designation of eligible telecommunications carriers."[109]

In November 2002, the Commission invited full reconsideration of "the specific concerns raised [by] the Rural Task Force . . . regarding excessive growth in the fund."[110] By the same token, the Commission again unequivocally affirmed the principle that "[s]upport for competitive ETCs currently is not capped under the Commission's rules."[111]

Throughout these developments, the Commission has maintained a consistent approach to purported financial pressure stemming from the designation of CETCs in rural study areas. Concerns over the allegedly "unsustainable" growth in "demand on universal service funding," the Commission concluded in its most recent decisions to designate ETCs pursuant to section 214(e)(6), lie "beyond the scope of" proceedings whose sole task is to decide whether to "designate[] a

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[103] *In re* Western Wireless Corp., 16 F.C.C.R. 48, 57 (2000).

[104] *Id.*

[105] *MAG Plan*, 16 F.C.C.R. at 11,326.

[106] *Id.*; *accord Joint Board Public Notice*, at ¶ 24. *See generally MAG Plan*, 16 F.C.C.R. at 11,293-99, 11,325-26.

[107] *MAG Plan*, 16 F.C.C.R.at 11,326.

[108] *Id.* at 11,294; *see also id.* at 11,297 ("at this time, the costs of adopting the Rural Task Force's proposal to freeze high-cost loop support . . . would significantly outweigh the potential benefits"); *id.* at 11,326 (expressing the Commission's concern that a freeze might "have had the unintended consequence of discouraging investment in rural infrastructure").

[109] *Id.* at 11,326.

[110] *November 2002 Order*, 17 F.C.C.R. at 22,646.

[111] *Id.*

particular carrier as an ETC."[112]

The proposition that fund growth should be treated as a factor relevant to the public interest in the designation of a new ETC has commanded majority support on a legal tribunal on exactly one occasion.[113] The Supreme Court of Utah has ruled that concern over financial pressure on *state* universal service funds can justify the denial of ETC status to a competitive wireless carrier.[114] The Utah decision supplies no persuasive support for considering the impact on the *federal* Universal Service Fund. The Utah court mistakenly assumed that its state's public service commission enjoyed unbounded discretion to construe the "public interest" standard established by the federal Telecommunications Act.[115] Indeed, the court went so far as to upbraid the unsuccessful ETC petitioner for failing to "cite[] any authority which explicitly limits the factors the PSC can consider in determining what is, or is not, in the public interest."[116] As I have already demonstrated, any public interest analysis must be anchored in the language, structure, and purposes of the 1996 Act. The Utah court's failure to recognize this principle undermines its decision. Even worse, the Utah court assumed that "additional ETC designations" in rural markets "could be in the public interest" only when "*incumbent* ETCs can reduce costs sufficiently such that" the designation of additional ETCs for rural markets would impose "no additional burdens . . . on the State Fund."[117] Such reasoning unacceptably conditions access to ETC status - and with it, access to universal service funding - on the financial well-being of incumbent carriers.

C. The Impossibility of Reconciling the "Financial Pressure" Argument with the Public Interest Framework of the ETC Designation Process

In refusing to translate IETC alarm over financial pressure on the USF into a high-cost support freeze or some other barrier to competitive entry, the Commission has stood on firm legal ground. Under current legal and economic conditions, incumbent wireline carriers hold the first ETC designation in virtually every rural area. The calculation of support according to these IETCs' embedded cost guarantees that *every* additional ETC designation in an overlapping market will increase the financial demands on the USF, even if only by a trivial amount. The *MAG Plan Order*'s description of the phenomenon leaves no doubt that the phenomenon stems from a lethal combination of current regulatory policy and the economic characteristics of a wireline

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[112] *In re* Cellular South License, Inc., 17 F.C.C.R. 24,393, 24,406 (2002); *In re* RCC Holdings, Inc., 17 F.C.C.R. 23,532, 23,545 (2002).

[113] On two occasions, individual members of the Federal Communications Commission have given credence to the proposition that financial pressure on the universal service fund may be relevant to the public interest. First, in a separate statement related to the Commission's *MAG Plan Order*, Commissioner Kevin J. Martin expressed "some concerns with the Commission's [longstanding] policy . . . of using universal support as a means of creating 'competition' in high cost areas." *In re* Multi-Association Group (MAG) Plan, 16 F.C.C.R. 19,613, 19,770 (2001) (separate statement of Martin, Comm'r). Despite "real pause" at the prospect that "subsidiz[ing] multiple competitors to serve areas in which costs are prohibitively expensive for even one carrier" might "lead[] to inefficient and/or stranded investment and a ballooning universal service fund," Commissioner Martin "sign[ed] on to an Order that may further this policy." *Id.* Second, in remarks before the 2003 meeting of the National Telecommunications Cooperative Association, Commissioner Jonathan S. Adelstein announced his belief that the Commission should "ensure that the benefits that come from increasing the number of carriers we fund outweigh the burden of increasing contributions [from] consumers." Jonathan S. Adelstein, *Rural America and the Promise of Tomorrow* (Feb. 3, 2003) (remarks prepared for the NTCA's annual meeting and exposition in Phoenix, Arizona). A speech such as Commissioner Adelstein's does not constitute Commission policy, but rather represents that Commissioner's personal views.

[114] *See* WWC Holding Co. v. Public Serv. Comm'n, 44 P.3d 714, 719-20 (Utah 2002).

[115] *See id.* at 719.

[116] *Id.*

[117] *Id.* (emphasis added).

telecommunications network: "[A]s an incumbent 'loses' lines to a competitive eligible telecommunications carrier, the incumbent must recover its fixed costs from fewer lines, thus increasing its per-line costs."[118] There is only one problem: indulging this argument affirmatively undermines the 1996 Act's agenda for preserving and advancing universal service. To treat this financial pressure - without regard to its magnitude, its policy implications, or its origins in regulatory decisions made consciously for the benefit of incumbent carriers - as a factor against competitive entry is inimical to every other element of the public interest.

Opponents of competitive entry frequently suggest, first, that sparse population spreads costs so thinly in rural areas that competitive carrier capture of IETC lines would increase the per-line cost of serving the remaining lines increases and, second, that this "harm" to an incumbent carrier outweighs any benefits derived from competition. In other words, the more remote the area, the more important it is to have exactly one carrier. Taken to their logical conclusions, these arguments counsel *per se* rejection of *all* petitions for CETC designation in rural areas. Such a refusal to embrace competitive entry into rural markets, however, is tantamount to rejecting all other fundamental tenets underlying the federal universal service program.

At a bare minimum, it offends the principle of competitive neutrality to subsidize incumbent carriers while simultaneously depriving their competitors of universal service funding. The 1996 Act prohibits schemes that permit incumbent carriers to fight freestyle with public funding, but require their competitors to contest high-cost markets according to the Marquis of Queensbury's rules. The law cannot tolerate purported public interest arguments that so systematically discriminate against carriers not only according to their competitive status, but also according to the technology that they deploy.

Nor can rural-urban parity justify a regime that would assign a negative weight to the putative costs associated with the designation of a competitive ETC. As matters stand, rural consumers do not enjoy parity with their urban counterparts. Parity cannot be achieved without high-cost support; it is very expensive to provide service to rural areas.[119] The Commission has deemed it "unreasonable to expect an unsupported carrier to enter a high-cost market and provide a service that its competitor" - presumably and perhaps invariably an incumbent - "already provides at a substantially supported price."[120] The paradigmatically procompetitive phenomenon of wireless-for-wireline substitution relies on universal service support and the ETC designation process that controls access to federal subsidies.[121] Although the federal universal service program has reduced some of the "differences in service costs between rural and urban markets," urban consumers continue to enjoy a choice of "at least two more competitors" offering wireless carriage relative to their rural counterparts.[122] Restricting CETC designations in rural areas would upset Congress's hope that "rural, insular, and high-cost areas" would have services "reasonably comparable" to those available in urban areas and at "reasonably comparable" rates.[123]

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[118]*MAG Plan*, 16 F.C.C.R. at 11,326.

[119]*See Alenco*, 201 F.3d at 617.

[120]*South Dakota Preemption Order*, 15 F.C.C.R. at 15,177; *see also First Report & Order*, 12 F.C.C.R. at 8932 (acknowledging that competition and affordable access to telecommunications service in high-cost areas depends on competitive neutrality as between competitive entrants and IETCs).

[121]*See* Annual Report & Analysis of Competitive Market Conditions with Respect to Commercial Mobile Servs., 16 F.C.C.R. 13,350, 13,438 & n.24 (2001) [hereinafter *Sixth CMRS Report*]; Annual Report & Analysis of Competitive Market Conditions with Respect to Commercial Mobile Servs., 15 F.C.C.R. 17,660, 17,788 & n.20 (2000) [hereinafter *Fifth CMRS Report*].

[122]Annual Report & Analysis of Competitive Market Conditions with Respect to Commercial Mobile Servs., 17 F.C.C.R. 12,985, 13,024 (2002) [hereinafter *Seventh CMRS Report*].

[123]47 U.S.C. § 254(b)(3).

Erecting barriers to competitive entry in rural high-cost areas would eviscerate another fundamental universal service principle: portability. The Commission's rules contemplate that CETC capture of customers from an incumbent carrier should trigger a concomitant transfer of universal service support from the incumbent to the CETC: "A competitive eligible telecommunications carrier shall receive universal service support *to the extent that the competitive eligible telecommunications carrier captures the subscriber lines of an incumbent local exchange carrier* . . . or serves new subscriber lines in the incumbent LEC's service area."[124] This regulation renders "the universal service subsidy . . . portable so that it moves with the consumer, rather than stay with the incumbent LEC, whenever a customer makes the decision to switch local service providers."[125] Portability converts USF support into a catalyst of technological innovation by enabling competitive ETCs to exert pressure on IETCs.[126] Far from the suggestion in this proceeding's Public Notice that "the Commission's rules [may] create an unfair advantage for ETCs with lower costs,"[127] superior operating efficiency is precisely what the Commission's rules should and do encourage. True to the grander "purpose[s] of universal service," portability of support within the federal universal service program "benefit[s] the customer, not the carrier."[128] In concert with competitive neutrality, portability helps ensure that "the market, and not local or federal government regulators, determines who shall compete for and deliver services to customers."[129] The regulatory virtue of portability should not be transmogrified through legal misinterpretation into a fiscal vice that purportedly menaces the liquidity of the USF.

Ultimately, the 1996 Act forbids the adoption of any policy that incorporates concerns over financial pressure on the USF into an analysis of the public interest, at least as long as the Commission adheres to an embedded-cost methodology for computing support levels. Careful examination of the Act itself confirms the inappropriateness of treating financial pressure on the USF as a component of the public interest analysis. As a matter of statutory interpretation, federal universal service policy cannot simultaneously retain an embedded-cost methodology for computing high-cost support to incumbent rural carriers while interpreting the term "public interest" within the meaning of section 214(e)(2) and (6) to prohibit ETC designations that increase financial demands on the USF. As long as the embedded-cost mechanism remains in force, the designation of a competitive ETC forces some growth in the USF as soon as the entrant captures at least one line previously served by the incumbent. In other words, any legal interpretation of the term "public interest" in which the supposed pressure of additional ETC designations on the high-cost component of the federal USF is assigned negative weight, categorically *no* ETC petitions beyond those confirming the eligibility of an incumbent rural telephone company can ever be approved.

Incumbent carriers are correct in one respect: wireless entrants are indeed capturing subscribers from wireline IETCs. The Commission has recognized the increased profile of wireless carriers in the telecommunications market.[130] Wireless-for-wireline substitution is quickening its pace. In its most recent study of the phenomenon, the Commission acknowledged "growing evidence that consumers are substituting wireless service for traditional wireline communications."[131] The Commission cited one study estimating "that, by the end of 2001, wireless had displaced 10

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[124] 47 C.F.R. § 54.307(a) (emphasis added).

[125] *Alenco*, 201 F.3d at 621.

[126] *See First Report & Order*, 12 F.C.C.R. at 8932.

[127] *Joint Board Public Notice*, at ¶ 17.

[128] *Alenco*, 201 F.3d at 621; *accord MAG Plan*, 16 F.C.C.R. at 11,257-58.

[129] *Alenco*, 201 F.3d at 616.

[130] *See Sixth CMRS Report*, 16 F.C.C.R. at 13,438 & n.24; *Fifth CMRS Report*, 15 F.C.C.R. at 17,788 & n.20.

[131] *Seventh CMRS Report*, 17 F.C.C.R. at 13,017; *accord* Verizon Wireless's Petition for Partial Forbearance, 17 F.C.C.R. 14,972, 14,979 (2002).

million access lines."[132] Another study cited by the Commission "estimates that 2 million households replaced an access line with a wireless phone in the first six months of 2001" alone.[133] The Public Notice announcing this proceeding acknowledges that "as of November 2001, 1.2 percent of households in the United States indicated that they had only wireless phones."[134]

To treat wireless-for-wireline substitution as a threat to the solvency of the USF and therefore a public interest consideration *against* competitive entry would turn deregulation on its head. Under no circumstances should the cost-effectiveness of a prospective ETC's service offerings should be counted as a *negative* in the applicable public interest analysis. The Commission has observed, squarely to the contrary, that a competitive ETC's ability to extend service to a remote area at low cost should be considered a strong contribution to the public interest:

> [T]o the extent that a competitive eligible telecommunications carrier offering an alternative to wireline technology can extend service to a remote . . . area at a substantially lower cost than a wireline carrier, we believe that it is a more economically efficient use of federal universal service funds to create incentives, in the first instance, for the lower-cost provider to provide the service.[135]

Federal universal service policy cannot maintain its commitment to competitive neutrality, rural-urban parity, and the portability of support if the interpretation of the "public interest" forecloses *all* high-cost funding of competitive carriers in rural areas. This catastrophic interpretation of the 1996 Act arises from the seemingly innocuous but ultimately fatal regulatory decision to postpone the implementation of a forward-looking financing methodology. As long as there is wireline-to-wireless migration, which is inevitable in a competitive and consumer-driven marketplace, there would be no realistic circumstances in which a competitive carrier could successfully petition to be designated as an ETC. That the prevalence of wireline-to-wireless migration – the epitome of competition and technological evolution – could affirmatively undermine a wireless carrier's quest for ETC status conclusively establishes the perniciousness and ultimate illegality of this approach. An interpretation of the term "public interest" that permits no ETC designations whatsoever, beyond the initial designation of a rural market's incumbent carrier, simply cannot stand.

IV. PROPOSED SOLUTIONS

A. A Forward-Looking Mechanism for Calculating and Distributing High-Cost Support

The best answer to the central question posed in this proceeding is the simplest: the Commission should retain its current approach of conducting proceedings designed to review a single ETC petition for a specific market without regard to concerns over allegedly excessive growth in the high-cost component of the USF. On the other hand, if excessive growth in the demand for high-cost support within the USF is considered a valid query within the public interest analysis required by section 214(e)(2) and (6), the Commission should address that purported problem in a fashion that is consistent with the public interest and the grander procompetitive purposes of the 1996 Act. The legal solution to this predicament lies in breaking the fatal combination of an embedded-cost methodology with the consideration of fiscal pressure on the USF as an element of the public interest. The simplest expedient lies retaining the Commission's current policy and

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[132] *Seventh CMRS Report*, 17 F.C.C.R. at 13,017.
[133] *Id.* at 13,017 n.214.
[134] *Joint Board Public Notice*, at ¶ 14.
[135] *In re* Western Wireless Corp., 15 F.C.C.R. 12,208, 12,241 (2000).

confirming what sound principles of statutory interpretation already dictate: refusal to consider the financial impact of ETC designations on the high-cost component of the USF. In the long run, however, the Commission cannot continue to defer what it has promised since 1997 but never delivered: computing incumbent carriers' support for delivering service to high-cost areas strictly according to forward-looking costs. The legitimate public interest considerations of competitive neutrality, technological evolution, and consumer choice dictate no less.

The real source of the problem is not competitive entry, but rather the continued use of an embedded-cost methodology for computing high-cost support to incumbent carriers in rural areas. In designing every other aspect of the federal universal service program, "the FCC decided to use the 'forward-looking' costs . . . of a carrier."[136] This commitment to a regulatory methodology based "on the costs an efficient carrier would incur (rather than the costs the incumbent carriers historically have incurred)" supplies a powerful tool for "encourag[ing] carriers to act efficiently."[137] A regulatory strategy with any pretense to economic efficiency must focus prospectively on costs to the exclusion of embedded-costs.[138] Because the "historical investments" in legacy networks are "sunk costs" and have no relevance to contemporary business decisions, prices in a competitive market react solely "to current costs."[139] The need to ignore historic costs in making "current pricing decisions," whether through market-based competition or through regulatory mechanisms designed to remedy competitive imperfections, is "particularly significant in industries such as telecommunications which depend heavily on technological innovation."[140]

With respect to the delivery of universal service support for high-cost areas, the law falls far short of economic ideals. The Commission's *First Report and Order* adopted a methodology using embedded cost in favor of "a cost model or other means of determining forward-looking economic cost . . . to calculate . . . support" to carriers "serving rural high cost areas."[141] At that time the Commission acknowledged "that calculating high cost support based on embedded cost is contrary to sound economic policy".[142] The Commission "conclude[d] that the 1996 Act's mandate to foster competition in the provision of telecommunications services in all areas of the country and the principle of competitive neutrality" would eventually "compel" the Commission "to implement support mechanisms that will send accurate market signals to competitors."[143]

The Commission originally anticipated "that forward-looking support mechanisms that could be used for rural carriers . . . will be developed within three years" of the 1997 release of the *First Report and Order*.[144] The long-awaited transition to a forward-looking methodology for computing high-cost support to rural carriers, however, has not yet occurred. Despite frequently reciting its

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[136] *TOPUC*, 183 F.3d at 407.

[137] *Id.*

[138] *See* DALE LEHMAN & DENNIS WEISMAN, THE TELECOMMUNICATIONS ACT OF 1996: THE "COSTS" OF MANAGED COMPETITION 66 (2000).

[139] *Alenco*, 201 F.3d at 615; *see also* ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS § 7.1, at 199 (2d ed. 1992) (observing that sunk costs "are usually visible," but arguing nevertheless that "they should always be ignored when making economic decisions"); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 1.1, at 7 (3d ed. 1986) ("[C]ost to an economist is a forward-looking concept"; costs already incurred "do not affect decisions on price and quantity."). "'Sunk costs' are unrecoverable past costs; practically every other sort of economic 'cost' is forward looking, or can be either historical or forward looking." Verizon Communications, Inc. v. FCC, 535 U.S. 467, 499 n.17 (2002).

[140] MCI Communications Corp. v. American Tel. & Tel. Corp., 708 F.2d 1081, 1116-17 (7th Cir. 1983).

[141] *First Report & Order*, 12 F.C.C.R. at 8934.

[142] *Id.* at 8935.

[143] *Id.*

[144] *Id.* at 8936.

intention to wean rural IETCs off an embedded-cost methodology and to align this system with the forward-looking cost methodology that governs non-rural carriers, the Commission has not yet implemented this strategy.[145] Under the Commission's current rules, the existing embedded-cost methodology will remain in place until 2006.[146] From the *First Report and Order* to the Public Notice announcing this proceeding, the Joint Board and the Commission have consistently recognized how the current funding method is wedded to IETC costs.[147] The reigning embedded cost methodology acts as a far more effective driver of growth in the USF than does competitive entry. Worse, continued reliance on embedded costs increases the cost of universal service in the worst possible way. It drives USF growth upward in order to compensate incumbent carriers whose average costs are rising in lock-step with their loss of market position to their competitors. The potential of this approach to divert precious public funds toward sustaining obsolete physical plant and may be the gravest source of inefficiency within the universal service program.[148]

A forward-looking mechanism is neither alien to the Commission's experience with universal service administration nor theoretically unattainable. A forward-looking mechanism is precisely what the Commission has adopted for calculating and distributing high-cost support to non-rural carriers.[149] In the rural context, Chairman Michael K. Powell has advocated "a permanent support mechanism, based on forward-looking costs," or at any rate a "measure of costs" more appropriate than incumbent carriers' per-line embedded costs, that would more effectively "ensure that the rural high-cost loop fund grows no larger than is truly necessary to accomplish its purpose."[150] If IETCs were truly concerned about relieving financial pressure on the USF, as opposed to using the regulatory process to fend off competitive challengers, they would advocate an immediate conversion to a funding formula that uses forward-looking costs and promotes full portability of USF support.

B. Informal Guidance on Public Interest Analyses Performed by State Commissions

The Joint Board should recommend several "permissive federal guidelines for states to use in designating ETCs pursuant to section 214(e)(2)."[151] ETC designation proceedings conducted by state commissions have a uniquely anticompetitive potential to squelch competitive entry into rural markets. Rules emerging from the proceedings that began with the Public Notice should prevent future abuses in universal service administration, especially at the state level. That a state commission is a creature of state law confers no immunity from the obligation to conduct ETC designation proceedings in accord with federal law. Any allegation that a state commission's "determination is inconsistent with [the 1996 Act] and its implementing regulations" unequivocally "involves [a] federal question" of law, subject to review and resolution in a federal forum.[152]

The Joint Board and the Commission should take special care to ensure that states properly analyze the public interest. Merely reminding state commissions that the "public interest" is a

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[145] *See MAG Plan*, 16 F.C.C.R. at 11,259; *In re* Federal-State Joint Bd. on Universal Serv., 14 F.C.C.R. 20,432, 20,439 (1999), *aff'd in part & rev'd in part sub nom.* Qwest Corp. v. FCC, 258 F.3d 1191 (10th Cir. 2001); *First Report & Order*, 12 F.C.C.R. at 8899, 8936.

[146] *See MAG Plan*, 16 F.C.C.R. at 11,258-29.

[147] *Compare First Report & Order*, 12 F.C.C.R. at 8932-34, 8944-45 *with Joint Board Public Notice*, at ¶ 15.

[148] *See* Wood Comments, at 11.

[149] *See* 47 C.F.R. § 54.309.

[150] *MAG Plan*, 16 F.C.C.R. at 11,360 (separate statement of Powell, Chairman).

[151] *Joint Board Public Notice*, at ¶ 34.

[152] BellSouth Telecommunications, Inc. v. MCImetro Access Transmission Servs., Inc., 317 F.3d 1270, 1278 (11th Cir. 2003). *See generally* Verizon Md., Inc. v. Public Serv. Comm'n, 535 U.S. 635 (2002).

statutory term of art and that this term draws its meaning from other statutory provisions would represent an enormous advance. Permissive guidelines would not prove especially burdensome to draft. Many of the Commission's rules already codify notions of competitive neutrality (including both neutrality as between carriers and technological neutrality), portability, and rural-urban parity. In the absence of the guidance that would be supplied even by a glance at the universal service principles listed in or authorized by section 254(b), state commissions remain vulnerable to appeals by IETCs to equate the public interest with incumbent protection. Permissive federal guidelines would therefore counteract the baneful tendency of some state regulators to transform the public interest into a weapon against competitive entry. They would also have the salutary side effect of harmonizing ETC designation proceedings across state lines. The federal universal service program demands uniformity with respect to contributions to the USF;[153] it should strive for similar regularity on questions of eligibility and of fund disbursement. As matters stand, the Commission designates ETCs in the absence of state-law jurisdiction.[154] The Commission should minimize the prospect of inconsistent standards for ETC designation within the national market for telecommunications service.

C. Conditions Imposed in State ETC Designation Proceedings

The Public Notice announcing this proceeding also seeks comment on the extent to which "similar universal service obligations or quality of service obligations [are] not imposed on incumbent LECs and competitive ETCs."[155] This question is arguably not phrased in a competitively neutral fashion, for it implicitly endorses one of the arguments most favored by incumbent carriers: the notion that state-law conditions must be imposed on top of the already extensive demands of the federal universal service program so that the law might impose regulatory symmetry with respect to regulatory burdens and benefits as between incumbent carriers and their competitors. IETCs eagerly advocate "parity of obligation and opportunity" within the universal service system, as long as new regulatory burdens fall invariably upon their competitors.

This unapologetically pro-incumbent view of regulatory symmetry overlooks certain essential legal propositions. Though they are quick to demand parity with respect to regulatory burdens and benefits as between incumbent and competitive carriers, incumbent carriers ignore the already extensive demands that the federal universal service program imposes upon competitive carriers seeking ETC status. "Congress appears to have contemplated" the arrangement that incumbent carriers decry: the federal universal service program does indeed permit the situation in which one carrier "wants to be designated as an ETC for an area already being served by a rural telephone company."[156] Indeed, an appropriate view of regulatory symmetry under the federal universal service program demands that the Commission and its state-law counterparts eschew prerequisites to ETC designation. An "incumbent LEC is required to make service available to all consumers upon request," but the incumbent can acquire and retain its ETC status even though it "may not have facilities to every possible consumer."[157] True to its belief that "the ETC requirements should be no different for carriers that are not incumbent LECs," the Commission has taken a consistent stand against service quality plans, carrier-of-last-resort (COLR) obligations, and tariff filing as prerequisites to ETC status.[158] The Commission has stated its contrary position as plainly as

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[153] *Cf.* 47 U.S.C. § 254(b)(4) ("All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.").

[154] *See id.* § 214(e)(6).

[155] *Joint Board Public Notice*, at ¶ 34.

[156] *In re* Western Wireless Corp., FCC No. 01-284, at ¶ 20, 2001 WL 1181249 (Oct. 5, 2001).

[157] *South Dakota Preemption Order*, 15 F.C.C.R. at 15,174.

[158] *Id.* at 15,174-75.

possible: "a new entrant can make a reasonable demonstration . . . of its capability and commitment to provide universal service without the actual provision of the proposed service."[159]

In the remainder of this section, I shall demonstrate how most conditions imposed in the course of state-law review of ETC designation petitions violate at least one of four sources of federal law: the public interest standard of 47 U.S.C. § 214(e)(2), the same statutory provision's requirement that a state commission "designate" eligible carriers, the general preemption provision of section 253, and the specific protection of mobile wireless carriers under section 332. The Joint Board should urge the Commission to codify these limits on state commissions' discretion in the form of advisory rules providing general guidance to the states.

1. The potential illegality of most state-law conditions. Federal law bars a state commission from imposing a service quality plan, especially one that mirrors an incumbent carrier's offerings. In its initial examination of the 1996 Act's universal service mandate, the Joint Board specifically addressed – and soundly rejected – a proposal to require competitive ETCs to develop and submit service quality plans as a condition of certification: "We are unpersuaded . . . that the Commission should institute specific standards to ensure that competitors provide the same quality service as the incumbent."[160] Instead, the Board "agree[d] . . . that competition should ultimately give carriers the incentive to provide quality services by allowing consumers to choose among various telecommunications providers."[161] The Commission's *First Report and Order* adopted the Board's recommendation "against the establishment of federal technical standards as a condition to receiving universal service support."[162]

Considerations of this sort underlie the Commission's insistence that "a telecommunications carrier's inability to demonstrate that it can provide ubiquitous service at the time of its request for designation as an ETC should *not* preclude its designation as an ETC."[163] At a minimum, therefore, requiring compliance with a service quality plan would violate the universal service principle of competitive neutrality. More pointedly, such a state-law condition on ETC designation violates section 253. This provision of the 1996 Act bans any "State or local regulation, or other State or local legal requirement, [that] prohibit[s] or ha[s] the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service."[164] Preemption under section 253 "is virtually absolute and its purpose is clear – certain aspects of telecommunications regulation are uniquely the province of the federal government and Congress has narrowly circumscribed the role of state and local governments in this arena."[165] A state's failure to satisfy even a single universal service principle, especially that of competitive neutrality, strips it of any ability to seek shelter from preemption. Indeed, a state's failure to ensure competitive neutrality in its administration of the universal service program requires the Commission to preempt state law.[166] Section 253(b) specifically conditions "the ability of a State to impose . . . requirements necessary to preserve and advance universal service" on the state's compliance with the principle that such requirements be

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[159] *Id.* at 15,178; *accord Cellular South*, 17 F.C.C.R. at 24,399; *RCC*, 17 F.C.C.R. at 23,538.

[160] *In re* Federal-State Joint Bd. on Universal Serv., 12 F.C.C.R. 87, 140 (1996) [hereinafter *First Recommended Decision*].

[161] *Id.*

[162] *First Report & Order*, 12 F.C.C.R. at 8831.

[163] *South Dakota Preemption Order*, 15 F.C.C.R. at 15,175 (emphasis added); *accord Cellular South*, 17 F.C.C.R. at 24,399; *RCC*, 17 F.C.C.R. at 23,538.

[164] 47 U.S.C. § 253(a). *See generally South Dakota Preemption Order*, 15 F.C.C.R. at 15,172-81 (analyzing federal preemption of anticompetitive regulations under state or local law).

[165] City of Auburn v. Qwest Corp., 260 F.3d 1160, 1175 (9th Cir. 2001).

[166] *See RT Communications*, 201 F.3d at 1269; *South Dakota Preemption Order*, 15 F.C.C.R. at 15,176.

set forth and applied "on a competitively neutral basis."[167]

Cognizant of state commissions' ability to manipulate ETC petitions by competitive carriers for anticompetitive purposes, the Commission has acted upon Congress's command to "preempt the enforcement of [any] statute, regulation, or legal requirement" that violates the federal mandate to remove barriers to entry into local and interstate telecommunications markets.[168] For instance, when the South Dakota Public Utilities Commission demanded that a carrier provide supported services throughout a service area before being designated as an ETC, the Commission preempted that state-law condition.[169] The Commission unequivocally declared that a state-law provision which effectively "require[s] the provision of service . . . prior to ETC designation" – unlawfully "prohibits or has the effect of prohibiting the ability of competitive carriers to provide telecommunications service."[170]

Quality of service requirements may violate an independent source of law. In its opinion partially affirming the Commission's *First Report and Order*, the Fifth Circuit recognized that the imposition of "such onerous eligibility requirements that no otherwise eligible carrier could receive designation . . . would probably run afoul of" section 214(e)'s charge that the Commission and its state-law counterparts "designate" eligible carriers.[171] Following this reasoning, the North Dakota Public Service Commission has concluded that a "requirement to be providing the required universal services to 100% of a service area before receiving designation as an ETC could be so onerous as to prevent any other carrier from receiving the ETC designation in any service area," going so far as to "require [North Dakota's] Commission to rescind the ETC designation already given to North Dakota ILECs."[172] The Federal Communications Commission has likewise recognized that section 214 provides an independent basis for invalidating burdensome state-law requirements imposed on competitive carriers.[173]

Similar reasoning has motivated the Commission's refusal to require CETCs to bear carrier-of-last-resort obligations. The Joint Board rebuffed the suggestion "that the Commission should require competing telecommunications carriers to meet all the obligations imposed by the state on the incumbent LEC, such as COLR requirements or rate regulation . . . to prevent unfair treatment of incumbent LECs."[174] Instead, the Joint Board "concluded that establishing specific federal rules or guidelines that would impose symmetrical regulatory obligations on all carriers receiving universal service support are unnecessary to protect the incumbent and would chill competitive entry into high-cost areas."[175] The Commission squarely rejected the suggestion that it "subject all eligible carriers to the regulatory requirements that govern ILECs, including pricing, marketing, service provisioning, and service quality requirements, *as well as carrier of last resort (COLR) obligations*."[176] Every tribunal that has considered the issue since the *First Report and Order* has

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[167] 47 U.S.C. § 253(b).

[168] *Id.* § 253(d).

[169] *See South Dakota Preemption Order*, 15 F.C.C.R. at 15,173.

[170] *Id.* at 15,169 (citing 47 U.S.C. § 253(a)).

[171] *TOPUC*, 183 F.3d at 418 n.31

[172] North Dakota Pub. Serv. Comm'n, Case No. PU-1564-98-428, at ¶ 36 (Dec. 15, 1999).

[173] *See South Dakota Preemption Order*, 15 F.C.C.R. at 15,174 & n.31; *see also id.* at 15,169 (acknowledging how state-law obstacles to the full accomplishment of § 214's purposes would merit federal intervention under traditional preemption doctrine, independent of the preemptive force of 47 U.S.C. § 253(a)).

[174] *First Recommended Decision*, 12 F.C.C.R. at 169.

[175] *Id.*

[176] *First Report & Order*, 12 F.C.C.R. at 8856 (emphasis added).

come to the same conclusion.[177] COLR and tariffing obligations therefore meet the same fate as service quality plans – illegality as a matter of federal law.

2. Section 332 and CMRS providers. The unique vulnerability of wireless carriers to technologically biased quality of service standards warrants careful examination of a legal provision, not otherwise mentioned in the Public Notice announcing this proceeding, that protects wireless carriers from improper regulation by state and local authorities. Section 332 of the Communications Act, as amended, provides that "no State or local government shall have any authority to regulate the entry of or the rates charged by any commercial mobile service or any private mobile service."[178] Congress adopted this preemptive measure as part of the Omnibus Budget Reconciliation Act of 1993[179] in order "to promote rapid deployment of a wireless telecommunications infrastructure."[180] By their nature, wireless communications markets transcend not only state boundaries but also the geographic footprints of legacy wireline networks.[181] "The plain language of this legislation manifests a clear Congressional intent to preempt the field" of wireless telecommunications regulation "with respect to rates and market entry."[182]

Again, regulatory symmetry – indeed, veritable parity of obligation and opportunity – does manifest itself in federal telecommunications law, simply not in the fashion that IETCs and their advocates would prefer. The 1993 amendment imposed regulatory symmetry along technological lines rather than jurisdictional distinctions based on inter- versus intrastate carriage or commercial versus private service.[183] Congress sought to "promote investment in . . . wireless infrastructure by preventing burdensome and unnecessary state regulatory practices."[184] Preemption under section 332 takes special aim at two of the likeliest obstacles to rapid rollout of wireless services: (1) the anticompetitive advantages inherent in incumbent local exchange carriers' ownership of the physical communications networks,[185] and (2) potentially anticompetitive regulatory intervention by state and local officials.[186]

Section 332 raises a formidable barrier to state-law regulation of carriers providing CMRS. The expansive scope of preemption under Section 332 is not limited to the direct regulation of rates. Instead, Section 332 also preempts any action that has the "effect" of regulating a CMRS carrier's rates.[187] State action is unlawful if it would "necessarily force [a CMRS carrier] to do more than required by the FCC."[188] Federal law "specifically insulates . . . FCC decisions" affecting CMRS

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[177]*See* Smith Bagley, Inc., Docket No. T-02556A-99-0207 (Ariz. Corp. Comm'n Dec. 15, 2000); Smith Bagley, Inc., Util. Case No. 3026 (N.M. Pub. Reg. Comm'n Aug. 14, 2001); RCC Minnesota, Inc., Docket No. UT-023033 (Wash. Util. & Transp. Comm'n, Aug. 14, 2002).

[178]47 U.S.C. § 332(c)(3)(A).

[179]Pub. L. No. 103-66, § 6002(b)(2)(A), 107 Stat. 312, 393 (1993).

[180]*In re* Rates of Wholesale Cellular Serv. Providers in Connecticut, 10 F.C.C.R. 7025, 7025 (1995), *review denied sub nom.* Connecticut Dep't of Pub. Util. Control v. FCC, 78 F.3d 842 (2d Cir. 1996).

[181]*See* Ball v. GTE Mobilnet, 81 Cal. App. 4th 529, 534, 96 Cal. Rptr. 2d 801, 804 (2000); H.R. REP. NO. 111, 103d Cong., 2d Sess. 260 (1993), *reprinted in* 1993 U.S.C.C.A.N. 378, 587.

[182]Bryceland v. AT&T Corp., 122 F. Supp. 2d 703, 707 (N.D. Tex. 2000).

[183]*See Connecticut DPUC*, 78 F.3d at 846.

[184]Implementation of Sections 3(n) & 332 of the Communications Act Regulatory Treatment of Mobile Servs., 9 F.C.C.R. 1411, 1421 (1994), *reconsideration dismissed in part and denied in part*, 15 F.C.C.R. 5231 (2000); *accord* Tenore v. AT&T Wireless Servs., 136 Wash. 2d 322, 335-36, 962 P.2d 104, 110 (1998).

[185]*See* U.S. West Communications, Inc. v. Washington Utils. & Transp. Comm'n, 255 F.3d 990, 992 (9th Cir. 2001).

[186]*See, e.g.*, Sprint Spectrum L.P. v. Town of Easton, 982 F. Supp. 47, 49-50 (D. Mass. 1997).

[187]Bastien v. AT&T Wireless Serv., Inc., 205 F.3d 983, 989 (7th Cir. 2000).

[188]*Id.*

carriers – including the conscious federal policy of leaving CMRS rates to market forces in lieu of regulation – from interference under state law.[189]

Any requirement that CMRS providers file a tariff as a condition of ETC designation would directly contravene Section 332. A state commission cannot deflect this provision's preemptive effect by describing the tariff as one ostensibly filed solely for "disclosure purposes." A wireless CETC would be barred from negotiating terms that deviate from those contained in the tariff. Even if the CETC could change its rates by filing a revised tariff, a state commission's potential ability to revoke ETC designation based on the tariffed rates would violate Section 332.[190] In short, any tariffing requirement opens the door to the very type of state regulation of CMRS providers that federal law forbids. "The tariff-filing requirement is . . . the heart of the common-carrier section of the Communications Act . . . . [R]ate filing [has historically been] Congress's chosen means of preventing unreasonableness and discrimination in charges. . . ."[191]

A state commission would violate Section 332 if it conditions USF eligibility on other terms and conditions of service contained in a tariff filed by a carrier seeking ETC status. Any "claim for inadequate services" raised by state regulators under color of patrolling a wireless carrier's "disclosure-only" tariff necessarily violates Section 332, since "[a]ny claim for excessive rates can be couched as a claim for inadequate services and vice versa."[192] Rates, which "do not exist in isolation" from services, "have meaning only when one knows the services to which they are attached."[193] In sum, Section 332's prohibition of state regulation of rates and entry by CMRS providers is broad enough to preempt not only direct ratemaking by a state, but also all other actions under color of state law that "raise the issue of whether [a customer] receive[s] sufficient service in return for the" rates charged by a CMRS provider.[194]

Section 332 works in concert with Section 253's more general prohibition of any "State or local statute or regulation, or other State or local legal requirement," that "prohibit[s] or ha[s] the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service."[195] Section 253's savings clause does safeguard "the ability of a State to impose, on a competitively neutral basis and consistent with section 254 . . . , requirements necessary to preserve and advance universal service."[196] Section 253 also provides, however, that "[n]othing in this section shall affect the application of section 332(c)(3) . . . to commercial mobile service providers."[197]

At a minimum, this interlocking cluster of provisions – consisting of a general preemption provision, a savings clause for state-law measures related to universal service, and an exception to the savings clause reinstating preemption under Section 332 in favor of CMRS providers – means that the general preemption provision of Section 253 governs an ETC designation proceeding,

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[189] *Id.*

[190] *See Central Office*, 524 U.S. at 228; *Bastien*, 205 F.3d at 989.

[191] MCI Telecommunications Corp. v. American Tel. & Tel. Co., 512 U.S. 218, 229 (1994); *accord* American Tel. & Tel. Co. v. Central Off. Tel., Inc., 524 U.S. 214, 223 (1998); *see also* Maislin Indus., U.S., Inc. v. Primary Steel, Inc., 497 U.S. 116, 126 (1990) ("The duty to file rates . . . and the obligation to charge only those rates have always been considered essential to preventing price discrimination and stabilizing rates." (citation omitted)).

[192] *Central Office*, 524 U.S. at 223; *accord Bastien*, 205 F.3d at 988; *Bryceland*, 122 F. Supp. 2d at 709.

[193] *Central Office*, 524 U.S. at 223.

[194] Gilmore v. Southwestern Bell Mobile Sys., Inc., 156 F. Supp. 2d 916, 924 (N.D. Ill. 2001).

[195] 47 U.S.C. § 253(a).

[196] *Id.* § 253(b).

[197] *Id.* § 253(e).

without the safe harbor otherwise granted to state regulations that are "necessary to preserve and advance universal service." When federal officials determine, as Congress and the FCC have in other contexts, that restrictive regulation of a particular area is not in the public interest, "States are not permitted to use their police power to enact such a regulation."[198] The most obvious interpretation of Section 253 is that preemption under Section 332 of state-law regulation of commercial mobile radio takes priority over state-law administration of the ETC designation process. Section 253 specifically addresses the role of state regulators in designating ETCs. Subsection (f) provides that "[i]t shall not be a violation" of federal law "for a State to require a telecommunications carrier that seeks to provide telephone exchange service or exchange access in a service area served by a rural telephone company to meet the requirements in section 214(e)(1)."[199] The 1996 Act, however, further specifies that "[t]his subsection shall not apply . . . to a provider of commercial mobile services."[200]

D. Miscellaneous Proposals

Finally, in response to certain questions posed by this proceeding's Public Notice, I wish to ensure that I deliver answers that are fully consistent with – and are perhaps dictated by – the legal analysis I have performed in these comments. The suggestion that "support [should] vary depending on an ETC's technology platform"[201] must be rejected, and emphatically so. Adjusting support according to the technology deployed by an ETC violates a fundamental principle of universal service. I have already laid out, in great detail, my argument against the proposition that "the support to competitive ETCs in high-cost areas should be subject to limitations similar to those imposed on support for incumbent LECs."[202] My proposal to accelerate the timetable for completing the transition of rural carriers from an embedded-cost methodology for calculating high-cost support to a forward-looking methodology therefore should be construed as an "appropriate" alternative to longstanding proposals "to freeze per-line support amounts available to . . . any competitive ETC in competitive study areas served by rural carriers."[203] Finally, I wish to note that my analysis is theoretically compatible with the possibility of basing high-cost support, on a competitively neutral basis, upon the costs of a lowest-cost provider of supported services in a rural market.[204] Should the Joint Board elect to recommend, and the Commission elect eventually to adopt, such an approach, "the extent [to which] the costs of competitive ETCs are lower than the costs of incumbent LECs" provides no cause whatsoever for regulatory concern, but rather makes an unequivocally positive contribution to the public interest in competition, technological progress, consumer welfare, and universal service.[205]

V. CONCLUSION

This proceeding's focus on the putative fiscal crisis sparked by growing demand for support in rural and high-cost areas should not obscure a more complete vision of universal service and of competitive wireless carriers' role within that agenda. Far from being incompatible with universal service, competition has the potential to solve many of the problems that still plague the

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[198] Ray v. Atlantic Richfield Co., 435 U.S. 151, 178 (1978); *accord* Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 708 (1984).

[199] 47 U.S.C. § 253(f).

[200] *Id.*

[201] *Joint Board Public Notice*, at ¶ 17.

[202] *Id.* at ¶ 23.

[203] *Id.* at ¶ 24.

[204] *See id.* at ¶ 19.

[205] *Id.*

administration of universal service in the United States. From the passage of the Communications Act of 1934 to the Bell breakup decree, local telephony remained the most intractable monopoly in the American economy.[206] Opening local telecommunications markets to competition thus represented the centerpiece of the 1996 Act.[207] Perhaps more than any other development during the past seven years, the opening of local telecommunications markets has directly advanced the purposes articulated in the preamble of the 1996 Act: to "promote competition and reduce regulation," "secure lower prices and higher quality services . . . and encourage the rapid deployment of new telecommunications technologies."[208]

The great shame is that rural and high-cost markets stand to benefit more, not less, than other markets in the transition from conventional public utility law to market-driven models of economic regulation. Because many localities are still served by no more than one telecommunications carrier, especially within rural America, an additional carrier's commitment to serve all customers represents a very significant improvement in consumer welfare. As substantially as competition can improve static economic conditions in rural and high-cost markets, its potential dynamic benefit is vastly greater. "Deregulation . . . contains its own technology policy, and a successful one at that."[209] The public interest in subsidizing rural telephony therefore rests in aggressive measures to roll out advanced telecommunications infrastructure and services to the geographic and economic limits of the republic. This aspect of universal service depends on three overarching factors. The public interest rests squarely on *competitive neutrality* (including neutrality as between carriers and technological neutrality), *rural-urban parity*, and the *portability* of subsidies among eligible carriers.[210] The failure to honor any of these principles, let alone all of them, betrays Congress's vision of universal service for rural America. The "[d]esignation of competitive ETCs promotes competition and benefits consumers in rural and high-cost areas by increasing consumer choice, innovative services, and new technologies."[211]

Above all, the Joint Board and the Commission must avoid the ancient trap of equating the public interest with the blind pursuit of incumbent protection. Telecommunications law, like the closely related field of antitrust law, protects "*competition*, not *competitors*."[212] Like that of the Sherman Act, the purpose of the 1996 Act "is not to protect businesses from the working of the market."[213] Neither the Telecommunications Act of 1996 nor the law of economic regulation has ever been interpreted to require the government to protect incumbent firms against changes in the marketplace "or to restore values that have been lost by the operation of economic forces."[214] The

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[206] *See Verizon v. FCC*, 535 U.S. at 475-76 ("The [Bell breakup] decree did nothing . . . to increase competition in the persistently monopolistic local markets, which were thought to be the root of natural monopoly in the telecommunications industry.").

[207] *See Iowa Utils. Bd.*, 525 U.S. at 371.

[208] Pub. L. No. 104-104, 110 Stat. 56, 56 (preamble).

[209] Chen, *Standing in the Shadows of Giants*, 71 U. COLO. L. REV. at 967.

[210] *See First Report & Order*, 12 F.C.C.R. at 8933.

[211] *In re* Western Wireless Corp., 16 F.C.C.R. 48, 55 (2000).

[212] Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962) (emphasis in original); *accord*, *e.g.*, Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 338 (1990); *cf.* Olympia Leasing Co. v. Western Union Tel. Co., 797 F.2d 370, 375 (7th Cir. 1986) (Posner, J.) (intimating that the antitrust laws should not "hold[] an umbrella over inefficient competitors").

[213] Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 458 (1993); *see also id.* ("The law directs itself . . . against conduct which unfairly tends to destroy competition itself. It does so not out of solicitude for private concerns but out of concern for the public interest.").

[214] Market St. Ry. Co. v. Railroad Comm'n, 324 U.S. 548, 567 (1945); *see also id.* at 554 (distinguishing the regulation of a common carrier's rates from the distinct "problem[s]" faced by "an enterprise that has passed its zenith of opportunity and usefulness, whose investment already is impaired by economic forces, and whose earning

pecuniary preferences of incumbent service providers cannot negate the public interest in additional service providers.[215] Regulators should not confuse the lawful "requirement of sufficient support for universal service within a [competitive] market" with the anticompetitive and unlawful demand that incumbent carriers be given "a guarantee of economic success."[216] When ILECs reflexively oppose competitive carriers' petitions for ETC designation in order to secure regulatory "protection from competition," such resistance represents "the very antithesis of the [1996] Act."[217]

possibilities are already invaded by competition from other" firms and technologies).

[215]*Cf.* Western Union Telegraph Co. v. FCC, 665 F.2d 1126 (D.C. Cir. 1981).

[216]*Alenco*, 201 F.3d at 625.

[217]*Id.* at 622.